BEFORE THE STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6120

Tariff filing of Central Vermont Public Service	)
Corporation requesting a 12.9% rate increase, to	)
take effect July 27, 1998	)

Docket No. 6460

Tariff filing of Central Vermont Public Service	)
Corporation requesting a 7.6% rate increase, to	)
take effect December 24, 2000	)

DIRECT TESTIMONY OF HELMUTH W. SCHULTZ, III AND DONNA DERONNE

ON BEHALF OF THE
VERMONT DEPARTMENT OF PUBLIC SERVICE

March 9, 2001

Summary: Mr. Schultz and Ms. DeRonne provide testimony and exhibits regarding the Company's overall revenue requirement.

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Helmuth W. Schultz, III. I am a Certified Public Accountant, licensed in the State of Michigan, and a Senior Regulatory Analyst in the firm of Larkin & Associates PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

I am Donna DeRonne, a Certified Public Accountant, licensed in the State of Michigan. I am a Senior Regulatory Consultant in the firm Larkin & Associates PLLC whose address was identified above.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES PLLC.

A. Larkin & Associates PLLC is a Certified Public Accounting and Regulatory Consulting firm that performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). The firm has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous electric, gas, water and sewer, and telephone utilities.

Q. HAVE YOU PREPARED AN APPENDIX WHICH DESCRIBES YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. We have attached Exhibits DPS-L&A-1 and L&A-2, which are summaries of our experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. Larkin & Associates PLLC was retained by the Vermont Department of Public Service ("Department"), to review the rate increase requested by Central Vermont Public Service Corporation ("CVPS"). Accordingly, we are appearing on behalf of the Department.

Q. ARE THERE ANY ADDITIONAL WITNESSES APPEARING ON BEHALF OF THE DEPARTMENT IN THIS PROCEEDING?

A. Yes. Among others, Department witness David Lamont will testify concerning purchased power cost issues. Mr. Lamont has recommended a reduction to power costs of $3,630,000. Additionally, he has recommended that $600,000 of expense be deferred and amortized over a three-year period, resulting in a net additional reduction in purchase power expense of $400,000. Combined, his adjustments result in a $4,030,000 reduction to purchase power expense and a $500,000 increase in rate base for the net rate year unamortized deferred costs.

Department witness Carole Welch will testify concerning Conservation and Load Management (C&LM) costs and Accounts Correcting for Efficiency (ACE) costs. Carole Welch's testimony recommends the DUP deferrals for the period 9/1/00 to 6/30/01 be limited to $103,739, and the EEU deferrals for the same period be limited to $59,499. Both of these amounts are prior to the application of carrying costs. On Exhibit DPS-L&A-3, Schedule 16, we calculate the estimated carrying costs on her recommended amounts, and the impact on CVPS's requested C&LM amortization expense. As shown on page 1 of Schedule 16, Ms. Welch's C&LM recommendations result in a $49,283 reduction to expense.

Additionally, Ms. Welch recommends that the Company's requested ACE deferrals be reduced by $594,055. As these costs are amortized over a two-year period, annual ACE amortization expense should be reduced by $297,028 to reflect Ms. Welch's recommendation. On Schedules 17 and 18, we calculated the impact of Ms. Welch's recommendations on rate base, as the average rate year unamortized C&LM and ACE deferrals are included as an addition to rate base. As shown on these schedules, rate base should be reduced by $221,775 for C&LM deferrals and $445,541 for ACE deferrals.

Department witness William Sherman sponsors testimony on Vermont Yankee costs. Mr. Sherman recommends the following adjustments to CVPS's share of costs allocated from Vermont Yankee: (1) decommission adjustment of $1,934,000; (2) Texas Compact principle adjustment of $765,000; (3) Texas Compact interest adjustment of $265,000; and (4) new sale transaction costs of $467,000. These amounts result in a net reduction to purchase power expense of $3,431,000. Mr. Sherman (as well as Dr. Steinhurst) also addresses a prudence issue related to Vermont Yankee power uprate. The related power uprate disallowance has not been reflected in the calculated revenue requirement at this time.

Department Witness Dr. William Steinhurst sponsors testimony addressing the Department's recommendations with regard to Hydro Quebec and power uprate at Vermont Yankee. Any Hydro Quebec prudence related adjustments or Vermont Yankee power uprate adjustments are not included in our revenue requirement calculations at this time.

The impact of the recommendations of Mr. Lamont, Ms. Welch and Mr. Sherman (with th exception of Vermont Yankee power uprate) on overall cost of service in Docket no. 6460 are reflected in our summary schedules. Any adjustments resulting from prudence issues have not yet been reflected.

Q. WHY ARE YOU TESTIFYING AS A PANEL INSTEAD OF INDIVIDUALLY?

A. As we are both testifying on cost of service and rate base issues, as well as the overall revenue requirement calculations, the subject matter of our recommendations are interwoven. Consequently, we are filing testimony as a panel instead of individually.

Q. DO YOU UNDERSTAND THAT AS A PANEL ONE OF YOU CAN ANSWER A QUESTION, BUT IF EITHER OF YOU HAS INFORMATION THAT INDICATES THAT AN ANSWER IS NEEDED THAT AMENDS OR GOES BEYOND THE OTHER'S ANSWER, YOU ARE OBLIGED TO GIVE THAT ANSWER?

A. Yes.

Organization

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. We will address, in order, the following:

II. Overall Financial Summary

III. Adjustments to Operating Income

IV. Rate Base

II. OVERALL FINANCIAL SUMMARY

Q. HAVE YOU PREPARED AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?

A. Yes, we have prepared Exhibit DPS-L&A-3, which consists of 18 schedules. Throughout this testimony, when a schedule is referred to, it is included in Exhibit DPS-L&A-3, unless noted otherwise. Additionally, we prepared Exhibit DPS-L&A-4, which consists of copies of CVPS's responses to various Department data requests. We have also provided workpapers further supporting some of the adjustments in our testimony.

Q. PLEASE DISCUSS EXHIBIT DPS-L&A-3, SCHEDULE 1, WHICH IS ENTITLED "COST OF SERVICE."

A. Schedule 1 presents the preliminary overall revenue requirement, giving effect to all the adjustments the Department witnesses, along with ourselves, are recommending in testimony. The operating expense adjustments appearing in Column (F) are taken from Schedule 2. The DPS Adjusted Return on Utility Rate Base appearing on line 16, Column (G), was determined by applying the Company's requested cost of capital of 9.22% to the overall Department recommended rate base presented on Schedule 3. The Company's requested overall cost of capital of 9.22% is presented on Schedule 4 for ease of reference.

As summarized on Schedule 1, the Department's analysis shows that CVPS should receive a preliminary rate increase of 1.81%, or $4,510,000 in Docket 6460. However, this amount does not include the impact of the Vermont Yankee power uprate issue, nor any impact from Hydro Quebec prudency related issues. Hydro Quebec issues are addressed in more detail in the testimony of Department witness Dr. William Steinhurst.

Q. PLEASE DISCUSS SCHEDULE 2 WHICH SUMMARIZES COST OF SERVICE, AS ADJUSTED.

A. Page 1 of Schedule 2 summarizes each of the recommended adjustments to CVPS's adjusted expense. The schedule distributes the adjustments to each of the respective expense categories that are impacted by the adjustment. Page 2 of Schedule 2 provides a reference for each of the adjustments listed on page 1, referring either to a specific schedule number or the testimony. If the adjustment is being sponsored by another Department witness, a reference to the witness is provided.

The adjustment presented on line 16 on page 2 of Schedule 2, titled Correction to Revenues from Ultimate Customers, is not carried over to page 1. Rather, it is carried over to Schedule

1, line 32, column (F), as it is an adjustment to test year revenues from ultimate customers, not expense. The Company agreed in response to DPS 3-25 that the test year revenues from ultimate customers were understated by $978,000 in its filing. This adjustment corrects the error.

III. ADJUSTMENTS TO OPERATING INCOME

Q. WOULD YOU PLEASE DISCUSS EACH OF THE ADJUSTMENTS TO OPERATING INCOME YOU ARE SPONSORING?

A. Yes. Specifically, we are recommending operating income adjustments in each of the following areas: Payroll expense, incentive compensation, payroll taxes, medical expense, capital expense, regulatory commission expense, Y2K cost amortization, Accounting Order amortization, Hydro Quebec ice storm arbitration amortization and income tax expense. We will discuss each of these adjustments in this section of our testimony. Additionally, our recommended adjustments to plant in service impact the requested depreciation expense. The resulting reduction in depreciation expense of $154,000 is reflected on Schedule 2.

<u>Corrections Agreed to by CVPS</u>

Q. PRIOR TO DISCUSSING EACH OF YOUR RECOMMENDED ADJUSTMENTS, COULD YOU ADDRESS ANY CORRECTIONS OR REVISIONS TO THE COMPANY'S FILING THAT SHOULD BE MADE?

A. Yes. According to the response to various Department Information Requests, certain corrections need to be made to CVPS's filing. These corrections are presented on page 2 of Schedule 2, lines 1 through 3. The corrections include: (1) $20,000 reduction to expense to correct the O&M expense savings calculation; (2) $270,000 reduction to overhead service restoration expense; and (3) $54,000 reduction to Millstone III decommissioning expense.

Q. COULD YOU PLEASE DISCUSS EACH OF THESE CORRECTIONS?

A. Yes. The first correction, which reduces expense by $20,000, actually results from three separate corrections to the Company's O&M expense savings adjustment. The first item reduces expenses by $7,000 to correct an error in the Company's adjustment spreadsheet. The second revision reduced expenses by $7,000 to correct the Company's estimated cost savings from replacing the lease payments for an old central processing unit with the actual lease payments for the new CPU. The final correction to O&M expense savings was an expense reduction of $6,000 to eliminate the remainder of the test year DASD maintenance costs. The Company indicated there will be no maintenance expenses related to the new DASD in the rate year.

The Company did indicate in response to DPS 3-25 that an additional savings of $5,000 should be reflected in its O&M cost savings reduction for the conversion of a boiler at the electrical maintenance facility. However, we recommend that the costs associated with the conversion of the boiler be excluded from CVPS's requested rate year plant additions later in this testimony. The Company provided no support for the anticipated project; consequently, we recommend that it be excluded. Consistent with this recommendation, we have not reflected the associated projected cost savings of $5,000 annually.

Q. PLEASE DISCUSS THE NEXT CORRECTION.

A. Overhead service restoration expense is typically based on a five-year average level when setting rates. This results in going-forward rates being based on a normalized level of such costs. In calculating the five-year average overhead service restoration cost level, the Company excluded the associated labor costs. Labor costs were included in calculating the average expense in all of the Company's past rate filings. In response to Department Information Request 3-68, the Company indicated that the exclusion of the labor cost component was an error. The correction of this error (i.e., reflecting labor costs with the total costs) resulted in an additional $270,000 reduction to test year expenses.

Q. PLEASE DISCUSS THE CORRECTION TO MILLSTONE III DECOMMISSIONING EXPENSE.

A. The Company's filing included $354,756 for the test year Millstone III decommissioning payment. In response to Department Information Request 4-8, the Company indicated that the test year expense also included a retroactive contribution. Reflecting the current cost of Millstone III decommissioning results in a $54,252 reduction to the expense level included in CVPS's filing. This correction is reflected on line 3 of Schedule 2, page 2.

Payroll Expense

Q. DID YOU REVIEW THE COMPANY'S REQUESTED LEVEL OF PAYROLL EXPENSE?

A. Yes. In determining rate year payroll, the Company began with test year payroll expense, excluding incentive pay. It then applied a cumulative wage increase for the periods 2000, 2001 and 2002 through June. To this result, the Company added 100% of its estimated rate year incentive compensation. The requested payroll expense is $24,446,216, which is $2,369,266 higher than the test year expense.

Q. IS THE REQUESTED PAYROLL EXPENSE REASONABLE?

A. No. The Company's request is overstated by $1,812,241. The base payroll calculation includes excessive non-union wage increases and officer promotion increases that are not appropriate. Furthermore, the amount included for overtime is excessive, bonuses are excessive and the amount included for incentive compensation is not known and measurable. Additionally, it is not appropriate to charge 100% of the incentive compensation to the ratepayers.

Q. WHY ARE THE NON-UNION WAGE INCREASES EXCESSIVE?

A. The Vermont Public Service Board ("PSB" or "Board") has recognized in past proceedings that the economy and the Company's need for cost control should be considered in determining what is a reasonable increase in compensation on a going-forward basis. When the Company chose to differentiate between a Company's union negotiated wage increases and non-union wage increases, the Board ruled that non-union increases should not exceed the negotiated union increases for setting rates. This is the situation that currently exists. The Company indicated that it requested an increase in rates because it could not wait any longer. Despite this need, the Company included in its filing increases in payroll for office and clerical, exempt and officers in excess of that granted to the union employees. This is not appropriate. We recommend that projected increases be limited to the arms-length negotiated increases being given and/or offered to the union employees.

Q. WHY ARE THE OFFICER PROGRESSION WAGE INCREASES INCLUDED IN THE COMPANY'S PAYROLL EXPENSE CALCULATION INAPPROPRIATE?

A. Officers are at a level of base compensation that is reasonable. To assume promotion increases are necessary and appropriate is just a means of granting more compensation to officers beyond the projected percentage wage increases. The Company compensates its officers at a level well in excess of other employees. Giving officers a percentage increase that is above that granted others and also giving officers a promotion increase is not an example of controlling costs. Officers do not get promotions at the same consistency as the general employee compliment since they are already at or near the top. Inclusion of a promotion increase for officers in determining rate year payroll expense is not appropriate in this case.

Q. WHAT IS WRONG WITH THE LEVEL OF OVERTIME INCLUDED IN THE

COMPANY'S PAYROLL CALCULATION?

A. The cost of overtime in the test year was $2,428,257. Overtime in the year 2000 was much lower, at $1,836,632. Test year overtime expense was higher than normal due to major storms in July and September of 1999, requiring the Company to incur an extraordinary level of overtime. The Company essentially ignored the fact that test year overtime exceeds overtime paid in any of the last four years. The Company then compounded this problem by increasing the test year level by an additional 8.87% or $215,386 for wage increases. This resulted in total requested overtime of $2,643,643. This level is not reflective of normal, on-going circumstances. Rates should not be set using this abnormally high level.

Q. WHAT CONCERN DO YOU HAVE WITH THE BONUSES INCLUDED IN PAYROLL EXPENSE?

A. The Company grants discretionary bonuses to employees for outstanding performance beyond the ordinary workload. This includes "multi-day storm duty by exempt employees, winning a large lawsuit, etc." (DPS 3-70). Some discretionary bonuses are also awarded as part of hiring employees for key positions. The test year included $271,194 of bonuses, which was inflated by 8.87% to $295,249 in the rate year. Most of the bonuses had to have been paid in either the latter part of 1999 or the first six months of 2000. The bonus amounts for 1999 and 2000 were only $164,161 and $189,385, respectively. The bonus is discretionary and the level of bonuses that will be granted in the rate year is not known. The number of storms in the rate year are not known, and any benefit from outstanding performance is enjoyed by ratepayers and shareholders alike. To include an inflated bonus that is already at a level that is higher than a normal annual level as an expense to ratepayers alone is not appropriate.

Q. WHY IS THE INCENTIVE COMPENSATION EXPENSE LEVEL REQUESTED BY THE COMPANY INAPPROPRIATE?

A. The Company expensed $626,481 in the test year for incentive compensation. In the Company's request for the rate year, it increased the incentive compensation expense significantly to $1,000,542. This is an increase of 59.7%. The Company claims the increase is part of the "evolution" of the incentive plan. There are a number of reasons this is not appropriate. In Docket No. 5724, the Board removed 50% of the Management Incentive Award. In the current proceeding, the Company claims that its current financial position requires it to seek an increase in rates, yet it also wants to significantly increase the incentive compensation level paid to management.

Customer satisfaction is a measurement in determining the incentive payout. However, the responses to DPS 3-80 and DPS 7-15 indicate customer satisfaction has declined. Employee input is another measure considered. In determining the plan payout, the Company, in preparation for the years activities, distributed to its employees eligible to receive incentive compensation a handout that establishes a connection between employee feedback and the incentive compensation payout. It is not hard to figure out the impact this will have on employee input. To the extent that the level of incentive payment hinges on favorable employee comments, it would be expected that the employees will comment favorably. There is no guarantee that incentive compensation will be paid (DPS 3-82). This means that the full amount requested by CVPS is not entirely known and measurable.

Q. HOW DID YOU DETERMINE YOUR RECOMMENDED ADJUSTMENT TO PAYROLL EXPENSE of $1,812,241?

A. Our adjustment is presented on Schedule 7. As shown on the schedule, we began with the June 30, 2000 employee complement and associated annualized salaries. The resulting annualized payroll cost of $25,601,295 was multiplied by the 74% O&M expense factor, resulting in the O&M base payroll expense of $18,944,958 as of June 30, 2000. The next step was to increase the June 30, 2000 base for the interim and rate year wage increases. To determine the 5.83% weighted average wage increase, we used the interim and projected rate year increases for union employees for each employee category. However, we did not include the promotion factor for officers. This increased the base payroll expense by $1,105,044 to $20,050,002. We reduced the base payroll by $148,536 to remove the equivalent of a net reduction of five employees. This is the employee reduction that occurred between June 30, 2000 and January 20, 2001. To the adjusted base of $19,901,466, we then added overtime expense of $2,301,006.

Q. HOW DID YOU DETERMINE THE RECOMMENDED LEVEL OF OVERTIME EXPENSE?

A. We began with the actual overtime time expense for each of the years 1997 through 1999 and grossed the amounts up to the year 2000 wage level based on wage increases granted. An average expense was computed for the years 1997 thru 2000. The resulting amount was inflated by the 5.74% overtime weighted average wage increase for the interim and rate year.

Q. PLEASE CONTINUE WITH YOUR EXPLANATION OF THE RATE YEAR PAYROLL EXPENSE CALCULATION.

A. As shown on Schedule 7, we then added an allowance for bonuses to the rate year payroll expense. Instead of adding the $295,249 bonus amount used by the Company, we estimated bonuses of $200,000 and assigned a 50% allocation to shareholders. This adds $100,000 to O&M payroll expense for bonuses.

Q. WHY DID YOU USE $200,000 AS YOUR BONUS ESTIMATE?

A. As previously noted, the bonuses for 1999 and 2000 were $164,161 and $189,385, respectively. We determined that $200,000 was reasonable, taking into consideration the average interim and rate year increase of 5.83%.

Q. WHAT LEVEL OF INCENTIVE COMPENSATION ARE YOU RECOMMENDING FOR INCLUSION IN THE RATE YEAR?

A. We utilized the actual test incentive compensation inflated by the 5.83% average interim and rate year wage increase. The resulting incentive compensation of $663,004 was then reduced by 50% or $331,502 for an equal sharing between ratepayers and shareholders. If a benefit is derived from improved performances that result in an incentive payment, then an equal sharing is appropriate. This is consistent with previous Board Orders.

Q. WHAT IS YOUR OVERALL RECOMMENDED ADJUSTMENT TO PAYROLL EXPENSE?

A. The result of our recommendations is a rate year expense of $22,633,975, which is $1,812,241 less than the Company requested expense of $24,446,215.

Payroll Tax Expense

Q. WHAT ADJUSTMENT ARE YOU MAKING FOR SOCIAL SECURITY TAXES?

A. Using the Company's effective tax rate of 7.3%, social security taxes should be reduced by $132,293. This adjustment is 7.3% of the $1,812,241 payroll reduction discussed above.

Medical Expense

Q. ARE YOU RECOMMENDING AN ADJUSTMENT TO OTHER PAYROLL RELATED COSTS?

A. Yes. The Company's estimated increase for medical insurance premiums in 2001 was 9%. Based on recent projections, we anticipated a greater increase and asked the Company to proved updated information. Based on the response to DPS 3-85, a 12% increase is now anticipated in the year 2001. Using the 12% increase instead of 9%, medical insurance expense should be increased $64,693. This adjustment is shown on Schedule 8.

<u>Capital Expense</u>

Q. PLEASE DISCUSS YOUR ADJUSTMENT FOR CAPITAL EXPENSE ON SCHEDULE 9.

A. Included in above the line expenses for ratemaking purposes are costs associated with the Company's letters of credit, the amortization of debt discount and expense on outstanding debt, amortization of loss on reacquired debt, and the amortization of preferred premium and issuance costs. This is consistent with the treatment of such costs in prior CVPS rate cases.

Included in CVPS's adjustment for capital expense are costs associated with a projected new credit facility that has not yet been entered into and, as of this writing, has not been approved. The new credit facility is estimated to be $20 million, and would be in addition to the $16.9 million in letters of credit the Company had outstanding during the test year. The Company's filing included $400,000 of estimated annual costs for commission/facility fees. It also included the $64,000 for the estimated rate year amortization of $128,000 of estimated facility issuance costs, which the Company projected to amortize over a twelve-month period, 50% of which would occur during the rate year. The inclusion also impacted rate base, as the 13-month average unamortized balance of the $128,000 of issuance costs would be included as an addition to rate base. We recommend that the estimated costs associated with the projected new credit facility be excluded. As shown on Schedule 9, page 1, test year expense should be reduced by $464,000. Page 2 of the schedule shows the impact on rate base, which is a reduction of $17,000.

Q. WHAT IS INCLUDED IN THE PROJECTED ISSUANCE COSTS OF $128,000?

A. The Company estimated the new credit facility issuance costs as follows: recording costs of $2,000; CVPS legal costs of $5,000; bank legal costs of $45,000; other costs such as travel of $1,000; and a one-time structuring fee of $75,000. The Company's original filing proposed that the $128,000 be amortized over a twelve-month period.

Q. SINCE THE COMPANY FILED ITS CASE, HAS IT REVISED THE ESTIMATED COSTS ASSOCIATED WITH THE NEW CREDIT FACILITY?

A. Yes, it has. While the Company still projects that it will enter a new $20 million credit facility, it reduced the estimated annual fees substantially, from $400,000 to $50,000. It has also reduced the estimated issuance costs from $128,000 to $103,000 and proposes to amortize those costs over three years instead of one year. The amortization period was lengthened as the Company now anticipates entering a three-year agreement instead of a one-year commitment. These amounts were provided in a preliminary answer to DPS 5-4, which we have attached as part of Exhibit DPS-L&A-4.

Q. HOW DID THE COMPANY DETERMINE THE REVISED ESTIMATED COSTS?

A. We are unsure. In response to DPS 4-1 (provided in Exhibit DPS-L&A-4), which also provided the revised estimated amounts, the Company indicated that it received proposals from three banks to provide a new credit facility secured by its billed and unbilled accounts receivable. The response indicated that the first year fees (including both one-time and annual costs) represented in the three proposals ranged from $100,000 to under $300,000. CVPS did not specifically state how it determined the new estimated annual costs of $50,000 and new estimated issuance costs of $103,000.

Q. WHY ARE YOU RECOMMENDING THAT THE ENTIRE NEW CREDIT FACILITY COSTS BE EXCLUDED?

A. The amounts still are not known and measurable. The Company has not provided any supporting documentation for its revised estimated amounts. CVPS still has not entered into a new credit facility, and it does not anticipate doing so until the end of March, which is after our testimony was due in this case. Even after we remove the costs associated with the proposed future credit facility, we are still allowing for the costs associated with the current annual letters of credit fees, consisting of $360,000 of annual frontage and commission fees for $16.9 million of outstanding letters.

<u>Regulatory Commission Expense</u>

Q. WHAT AMOUNT HAS CVPS INCLUDED IN COST OF SERVICE FOR REGULATORY COMMISSION EXPENSE?

A. In COS Adjustment Number 16, CVPS included $992,504 for regulatory commission expense, which was $174,551 less than the actual recorded test year level. The requested amount is based on the five-year average of costs incurred for various dockets at both State and FERC levels. The level of costs incurred over the five-year period ranged from a low of $491,244 during the twelve-months ended June 30, 1996 to a high of $1,576,037 during the twelve-months ended June 1999.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE REQUESTED EXPENSE LEVEL?

A. Yes. As shown on Schedule 10, we recommend that costs associated with two specific cases be removed for purposes of calculating the five-year average cost level. The cases include Vermont PSB Docket No. 6133 - Holding Company and the Patch Case in Federal District Court. The costs associated with the two dockets should not be charged to Vermont ratepayers; consequently, the costs should be excluded in calculating the five-year average expense level. Removal of these two dockets results in a $278,077 reduction in CVPS's requested regulatory commission expense.

Q. WHY DO YOU RECOMMEND THAT COSTS ASSOCIATED WITH DOCKET 6133 BE REMOVED FROM THE FIVE-YEAR AVERAGE CALCULATION?

A. The purpose of Docket 6133 was for CVPS to set up a separate holding company in preparation for potential electric industry deregulation. The formation of a separate holding company would primarily benefit CVPS's shareholders, not its ratepayers. Consequently, the ratepayers should not be responsible for funding such costs. As shown on Schedule 10, expenses of $203,498 were incurred in the twelve-months ended June 30, 1999 for this docket, and $187,994 was incurred during the twelve-months ended June 30, 2000. These amounts should be removed in calculating the five-year average expense level.

Q. PLEASE DISCUSS THE PATCH CASE.

A. Included in the five-year average regulatory expense calculation is $822,581 recorded as expense on CVPS's books in the twelve-months ended June 30, 1999 and $146,995 in the twelve-months ended June 30, 2000 for the Patch Case. This is only 50% of the total costs associated with the case in those periods, as the other 50% was recorded on the books of Connecticut Valley Electric Company Inc. (CVEC). CVEC is Central Vermont's wholly owned subsidiary that serves New Hampshire and is regulated by the New Hampshire Public Utility Commission (NHPUC). The majority of the costs were for outside legal services.

The NHPUC denied CVEC's recovery of a portion of power costs for power purchased from Central Vermont. The NHPUC determined that CVEC was imprudent for not terminating its FERC authorized power contract with Central Vermont to take advantage of lower market costs. This issue has been the subject of several New Hampshire decisions and numerous appeals at both the New Hampshire state and the Federal level. According to CVPS's response to DPS 3-106, "Central Vermont and CVEC joined a federal district court action (the Patch Case) initiated by Public Service Company of New Hampshire to argue that FERC has exclusive jurisdiction over CVEC's ability to recover wholesale power costs from its retail customers." The response also indicates that the federal district judge in that case upheld FERC's exclusive jurisdiction and CVEC's right to recover the associated power costs. The circuit court of appeals affirmed the federal district judge's decision. The NHPUC has filed a writ of certiorari with the United States Supreme Court, who has not yet decided to accept the case for review.

Q. SINCE THE PATCH CASE CLEARLY INVOLVES DECISIONS AND ACTIONS THAT WERE TAKEN IN THE NEW HAMPSHIRE JURISDICTION, WHY HAS THE COMPANY INCLUDED 50% OF THE COSTS ON CVPS'S BOOKS IMPACTING THE VERMONT RATEPAYERS?

A. In response to DPS 3-106(b), the Company indicated that in both the Federal and FERC proceedings, the New Hampshire Public Utility Commission was "...trying to shift CVEC's stranded costs to Central Vermont and its Vermont retail customers." The Company also indicated that the benefits of this case went to both CVEC and the Vermont retail customers, so it split the costs 50/50 between CVEC and Central Vermont.

Q. IS THE COMPANY'S REASONING COMPELLING?

A. No, it is not. The case involves decisions made by the New Hampshire Public Utility Commission regarding costs incurred by CVEC to be passed on to CVEC's New Hampshire customers. Vermont ratepayers should not, in any way, be responsible for funding any of the associated legal costs, and should definitely not be responsible for 50% of those costs. On

Schedule 10, we removed all of the costs associated with this New Hampshire case from the calculation of the five-year average regulatory commission expense. We provided the portions of CVPS's response to DPS 3-106 addressing the Patch Case issue in Exhibit DPS-L&A-4, at pages 7 through 19.

Q. ARE THERE ANY ADDITIONAL REASONS THAT THIS CASE SHOULD BE EXCLUDED IN DETERMINING THE FIVE-YEAR AVERAGE?

A. Yes. As previously mentioned, $822,581 was included in the twelve-months ended June 30, 1999 for 50% of the costs incurred in that year for the Patch Case. Costs associated with 24 separate cases were recorded as regulatory commission expenses in that year. The Patch Case consisted of over 50% of the total regulatory commission expenses recorded on CVPS's books for that year. The costs for that year were the highest amount included in determining the 5-year average expense level. Clearly this one case greatly skewed the overall five-year average calculation.

Y2K Cost Amortization

Q. PLEASE DISCUSS THE COMPANY'S Y2K COST REQUEST.

A. CVPS deferred $2,896,321 for Y2K compliance costs during the period December 1997 through October 2000. Of this amount, $30,790 was deferred in December 1997, $2,173,001 in 1998, $562,141 in 1999 and $130,388 in 2000 through October. The Company began amortizing the Y2K compliance costs on its books, using a five-year amortization period, during January 2000. Included in the Company's filing is $534,381 for the Vermont regulated portion of annual amortization expense and $1,603,125 as an addition to rate base for the average rate year unamortized balance.

Q. WHAT IS THE BASIS FOR THE DEFERRAL?

A. On March 11, 1998, CVPS requested that the Board issue an accounting order directing it to book estimated Year 2000 compliance costs of approximately $2.1 million to Other Regulatory Assets, and to amortize the costs over five-years beginning in January 2000. On June 10, 1998, the Board declined to issue the requested accounting order, directing the Company to recognize the Y2K costs in the periods incurred. On June 23, 1998, the Company asked the Board to reconsider. On July 22, 1998, the Board rescinded its June 10, 1998 Accounting Order, indicating that it would reconsider the request.

On August 31, 1998, the Board issued an Accounting Order for Year 2000 Compliance Costs which permitted the Company to defer certain Y2K related compliance costs, subject to specific conditions. It is under the August 31, 1998 Accounting Order that CVPS has deferred its Y2K compliance costs. However, the amount of Y2K costs CVPS deferred on its books and is requesting recovery of in this case is not in compliance with the Accounting Order.

Q. PLEASE EXPLAIN.

A. The August 31, 1998 Accounting Order specifically states as follows:

> The Company is authorized to defer and shall defer the recognition of the Year 2000 compliance costs that would otherwise be recognized in 1998, and shall commence the amortization of such costs on January 1, 2000. Such costs shall be recorded in FERC account 182.3 and amortized over five years.

This paragraph in the Order specifically limits the amounts to "costs that would otherwise be recognized in 1998..." As previously mentioned, the amount the Company deferred included not only costs that would have been recognized in 1998, but costs incurred in 1997, 1999 and the year 2000 as well. In the first paragraph of the order, the Board states: "For the reasons explained below, and <u>subject to the conditions set forth below</u>, the Board grants the requested accounting order." (Emphasis added) One of the specific conditions in the order was the limitation to the 1998 costs.

Q. HOW DO THE AMOUNTS ACTUALLY INCURRED COMPARE TO THE AMOUNTS ORIGINALLY ESTIMATED BY THE COMPANY?

A. According to the August 31, 1998 Accounting Order, CVPS's March 11, 1998 request for accounting order indicated that it estimated Year 2000 compliance costs of approximately $2.1 million. This is close to the amount of Y2K costs deferred on the Company's books during 1998 of $2,173,000. However, the total amount deferred by the Company over the period December 1997 through October 2000 was approximately $2.9 million.

Q. SHOULD THE Y2K COMPLIANCE COSTS INCLUDED IN THE FILING BE ADJUSTED?

A. Yes. Consistent with the clear and specific language of the August 31, 1998 Accounting Order for Year 2000 Compliance Costs, the amount to be amortized for ratemaking purposes should be limited to the costs actually incurred during 1998. CVPS never received permission to defer costs incurred prior to or subsequent to that period.

Q. SHOULD ANY REVISIONS BE MADE TO THE AMOUNTS ACTUALLY RECORDED TO THE DEFERRAL DURING 1998?

A. Yes. According to the response to DPS 8-4, Attachment 8-4-12, part of an accrual recorded in December 1998 was for a $24,000 labor estimate that did not occur during 1998. Since these labor costs did not occur during 1998, they should be excluded from the 1998 amounts.

According to the response to DPS 4-19, Attachment 4-19A, there were several charges that were initially recorded in the Y2K deferral in error that were subsequently reversed. Several of these items were charged to the deferral during 1998 and not reversed until 1999. Consequently, the 1998 Y2K costs need to be reduced for these errors that were reversed in 1999. As shown on page 1 of Schedule 11, a total of five charges need to be removed, totaling approximately $149,000. CVPS's response to DPS 4-19 has been provided in Exhibit DPS-L&A-4, pages 22 through 44.

Q. WHAT ADJUSTMENT IS NECESSARY?

A. As shown on Schedule 11, page 1 of 2, Y2K amortization expense should be $368,000 on a

Vermont regulated basis, which is $166,000 less than the amount included in the Company's filing. Additionally, as shown on page 2 of the schedule, rate base should be reduced by $499,000 to reflect only the average rate year unamortized portion of the Y2K compliance costs incurred during 1998.

<u>Accounting Order Amortization</u>

Q. ARE THERE ADDITIONAL ACCOUNTING ORDERS THAT IMPACT RATE YEAR EXPENSES FOR WHICH YOU ARE RECOMMENDING ADJUSTMENTS?

A. Yes. On January 29, 2000, the Board issued three separate Accounting Orders impacting CVPS. These include: (1) Accounting Order for Deferral of Incremental Hydro-Quebec Ice Storm Arbitration Costs; (2) Accounting Order for Deferral of Docket No. 6270 Costs; and (3) Accounting Order for Deferral of Retail Choice Petition Costs and Public Service Department Electric Utility Industry Restructuring Bill-Backs.

Q. COULD YOU BRIEFLY DISCUSS EACH OF THESE THREE ACCOUNTING ORDERS?

A. Prior to discussing the specifics of each Accounting Order, it should be stated that each of the three Accounting Orders contain the following provision:

> This Order is limited to the accounting treatment for the subject costs and does not bar any party from contesting, or the Board from determining or disallowing, the reasonableness or prudence of such costs, or the ratemaking treatment of such costs, in whole or in part, in any rate proceeding.

Under the Accounting Order for Deferral of Retail Choice Petition Costs and Public Service Department Electric Utility Industry Restructuring Bill-Backs, the Company was permitted to defer actual incremental costs incurred in connection with its Retail Choice Petition and costs billed by the Department for electric utility industry restructuring. In the current filing, the Company is requesting a five-year amortization of estimated deferrals of $477,540. This results in annual amortization expense of $95,508 and a $429,786 increase in rate base for the average unamortized balance. The $477,540 requested deferral consists of $50,021 of costs actually incurred through August 31, 2000, estimated deferrals of $302,520 for the period September 1, 2000 through December 31, 2000, and estimated deferrals of $124,999 for the period January 1, 2001 through June 30, 2001. According to DPS 4-14, the Company did not actually defer any costs for the period September 1 through December 31, 2000, and the current estimated deferrals for the period January 1, 2001 through June 30, 2001 is $150,000. These amounts are considerably lower than the estimates included in the filing.

DPS 4-14(d) asked the Company to explain, in detail, how its estimated deferrals were determined. The Company merely responded that the estimated deferrals for the period January 1, 2001 through June 30, 2001 are the budgeted costs for that period and was provided by the responsibility center managers. No additional detail or support was provided.

Q. PLEASE DISCUSS THE DOCKET 6270 ACCOUNTING ORDER.

A. Under the Accounting Order for Deferral of Docket 6270 Costs, the Company was permitted to defer actual incremental costs incurred in connection with Docket 6270 - Small Power Producers. In the current filing, the Company is requesting a five-year amortization of estimated deferrals of $435,577. This results in annual amortization expense of $87,120 and a $392,017 increase in rate base for the average unamortized balance. The $435,577 requested deferral consists of $346,011 of costs actually incurred through August 31, 2000, estimated deferrals of $45,820 for the period September 1 through December 31, 2000, and estimated deferrals of $43,746 for the period January 1, 2001 through June 30, 2001. According to DPS 4-13, the actual total deferrals through December 31, 2000 was $382,242.

DPS 4-13(d) asked the Company to explain, in detail, how its estimated deferrals were determined. The Company merely responded that the estimated deferrals for the period January 1, 2001 through June 30, 2001 are the budgeted costs for that period and was provided by the responsibility center managers. No additional detail or support was provided.

Q. ARE YOU ADDRESSING THE HYDRO QUEBEC ICE STORM ARBITRATION DEFERRALS?

A. We will address the Hydro Quebec ice storm arbitration costs deferrals in a subsequent section of this testimony.

Q. WERE THERE ANY SUBSEQUENT ACTIONS BY THE BOARD THAT IMPACT THE THREE JANUARY 29, 2000 ACCOUNTING ORDERS?

A. Yes. On April 13, 2000, the Department and CVPS entered a Stipulation regarding the implementation of a new rate design which eliminated seasonal rates. On June 8, 2000, the Board issued an Order in Docket No. 6120 which approved the Stipulation. While the deseasonalization of rates was revenue neutral on an annual basis, it did result in incremental revenues during the year 2000 because the rate re-design went into effect in the middle of the year. The Stipulation between the Department and CVPS contained the following provision with regards to the incremental revenues:

> The Parties hereby agree that to the extent the implementation of deseasonalized rates in tariffs and special contracts result in the collection of revenues for jurisdictional services from the Company's retail customers during the twelve (12) months ending December 31, 2000 are in total greater than the revenues that would have been collected under CVPS's current retail rates during the same period, any excess revenues will be applied so as to reduce or eliminate the accounting deferral recorded in the other Regulatory Assets Account 182.3 (as defined in the Federal Energy Regulatory Commission Uniform System of Accounts) as authorized by the Board in Accounting Orders issued on January 29, 2000.

The Accounting Orders issued on January 29, 2000 were the three addressed above.

Q. HOW DID THE COMPANY ADDRESS THE INCREMENTAL REVENUES IN ITS FILING?

A. The Company used its total estimated incremental revenues from deseasonalization (which it estimated at $4,247,232) to offset the deferred Hydro Quebec ice storm arbitration costs. It did not apply any of the amount towards the other two January 29, 2000 Accounting Order deferrals.

Q. DO YOU AGREE WITH THIS TREATMENT?

A. No. We recommend that the incremental revenues be used to offset the other two deferrals first. The incremental revenues are enough to completely eliminate the actual deferrals to date for the Docket 6270 costs and the Retail Choice Petition/Department restructuring bill-backs. Consequently, we removed all of the amortization expense associated with theses two Accounting Orders on Schedule 2. We also removed the amount included in rate base by the Company for its projected average unamortized balances on Schedule 3.

Q. WHAT WAS THE ACTUAL AMOUNT OF INCREMENTAL REVENUES RECEIVED BY CVPS DURING 2000?

A. According to DPS 4-10 (provided partially in Exhibit DPS-L&A-4), the actual 2000 incremental revenues from deseasonalization were $3,590,200. As shown on Schedule 12, offsetting the incremental revenues by the actual deferrals through December 31, 2000 for the two Accounting Orders would result in remaining incremental revenues of $3,157,937.

Q. WHAT SHOULD BE DONE WITH THE REMAINING INCREMENTAL REVENUES?

A. As will be discussed later in this testimony, we recommend that the Hydro Quebec ice storm arbitration costs continue to be deferred for ratemaking purposes. Consequently, the remaining incremental revenues should continue to be deferred until the Company's next rate case proceeding. At that time, the Company could first offset any additional actual costs incurred subsequent to December 31, 2000 for Docket 6270 and the Retail Choice Petition and Department electric restructuring bill-backs. The remaining balance would then be used to offset the deferred Hydro Quebec ice storm arbitration costs, which would be addressed in the future rate case proceeding.

<u>Hydro Quebec Ice Storm Arbitration Costs</u>

Q. WOULD YOU PROVIDE A MORE DETAILED DISCUSSION OF THE HYDRO QUEBEC ICE STORM ARBITRATION COSTS?

A. An ice storm in January 1998 damaged major components of the Hydro-Quebec transmission system over which power is supplied to Vermont under the VJO Power Contract (of which CVPS is a party), resulting in a 61-day interruption of scheduled contractual energy deliveries into Vermont. As a result, the VJO examined Hydro Quebec's reliability and ability to deliver energy. The VJO determined as a result of the examination that Hydro Quebec is unable to make available capacity to the degree of firmness required by the Power Contract. Consequently, the VJO initiated an arbitration proceeding, seeking to terminate the Hydro Quebec contract, recover damages associated with failure to comply with the contract, and recover capacity payments made during the period of non-delivery.

In a January 29, 2000 Accounting Order, the Board authorized the Company to defer the recognition of actual incremental Hydro-Quebec ice storm arbitration costs. The Board's Accounting Order stated that the costs would be recorded in Other Regulatory Assets and

"...amortized to cost of service over a 60-month period beginning with the implementation of rates in any rate proceeding." As previously mentioned, the Accounting Orders issued on January 29, 2000 were specifically limited to the accounting treatment of the costs and did not determine the ratemaking treatment for such costs.

Q. PLEASE DISCUSS THE AMOUNTS DEFERRED BY CVPS UNDER THE ACCOUNTING ORDER.

A. In the current filing, the Company requested a five year amortization of estimated deferrals of $7,195,466. It offset the estimated deferrals by $4.25 million for estimated incremental revenues and $195,569 associated with Lyndonville HQ sellback arbitration, essentially resulting in a net deferral request of $4,442,701. This results in annual amortization expense (assuming the offsets) of $550,553 and a $2,477,490 increase in rate base for the average unamortized balance. The $7,195,466 of requested deferral consisted of $6,211,418 of costs actually incurred through August 31, 2000, estimated deferrals of $864,048 for the period September 1, 2000 through December 31, 2000, and estimated deferrals of $120,000 for the period January 1, 2001 through June 30, 2001. According to DPS 4-9 (provided in Exhibit DPS-L&A-4), the actual total deferrals for September 1, 2000 through December 31, 2000 were $105,478, which is considerably lower than the projected amount of $864,048. Additionally, the actual amount of incremental revenues from deseasonalization, which were previously addressed, were considerably lower than the $4.25 million included in the Company's calculation.

Q. WHAT IS THE CURRENT STATUS OF THE HYDRO QUEBEC ICE STORM ARBITRATION?

A. According to DPS 8-8, the hearings are completed and it is under advisement with the Arbitration Tribunal. The Company expects the award to be rendered by the Tribunal in March 2001.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARDS TO THE HYDRO QUEBEC ICE STORM ARBITRATION DEFERRALS?

A. We recommend that the amounts continue to be deferred, with no rate recognition at this time. It still is not known what the ultimate outcome of the arbitration will be. As part of the arbitration, the VJO is seeking to terminate the Hydro Quebec contract, recovery of damages and recovery of past capacity payments. Clearly the Company is hoping that it will receive some benefits, possibly substantial, as a result of the arbitration. The arbitration costs should continue to be deferred until the matter is resolved. It would not be appropriate to reflect the costs associated with the arbitration in rates when the future benefit that the Company hopes to receive is not also reflected. The costs should be recognized in a future rate case in order to match the costs with the resulting benefits. It would not be appropriate to ask ratepayers to begin funding these costs now.

Q. DID THE JANUARY 29, 2000 ACCOUNTING ORDER ADDRESS WHEN THE

AMORTIZATION OF THE COSTS WAS TO BEGIN?

A. First, it needs to be restated that the Accounting Order specifically indicated that it was limited to the accounting treatment only, not the treatment for ratemaking purposes. Additionally, the Order stated that the costs should be "...amortized to cost of service over a 60-month period beginning with the implementation of rates in any rate proceeding." The Order did not specifically state the next rate proceeding. We recommend that the Company continue to defer these costs until a subsequent rate case that occurs after the matter has been resolved. As shown on Schedule 2, page 2, we removed the amount of net amortization expense CVPS included in its filing for the deferred Hydro Quebec arbitration costs of $550,000. We also removed the amount CVPS included in rate base for the average rate year unamortized balance of $2,477,000.

Q. WHY DID YOU REMOVE THE UNAMORTIZED COSTS FROM RATE BASE?

A. CVPS should not receive a return on these costs. The arbitration will benefit the Company's shareholders as well as its ratepayers. While it is quite possible that the ratepayers will be required to fund the arbitration costs at some point in the future, after the matter is resolved, they should not also have to provide a return on the costs.

Income Tax Expense

Q. WHAT IS THE PURPOSE OF THE ADJUSTMENT TO INCOME TAX EXPENSE PRESENTED ON SCHEDULE 5?

A. The adjustment presented on Schedule 5 reflects the impact of our recommended adjusted Return on Utility Rate Base and the weighted cost of debt rate on the Company's proposed income tax expense. The calculations are identical to the Company's calculations, with two exceptions. We replaced CVPS's proposed return on utility rate base amount with our recommended amount. Additionally, in calculating the interest expense reduction from the return on utility rate base, we substituted the Company's rate base amount with the Department's recommended rate base and used the Company's weighted cost of debt.

IV. RATE BASE

<u>Utility Plant In Service</u>

Q. PLEASE DISCUSS THE COMPANY'S ADJUSTMENT TO TEST YEAR UTILITY PLANT IN SERVICE IN DOCKET NO. 6460.

A. The Company's additions to the various categories of plant treated test year plant that was completed but not classified, construction work-in-progress and projected projects for the interim year and rate year as if they were in service during the rate year. Each plant category presented the various types of additions as either test year, interim period or rate year additions. The Company's adjustments to plant in service increased rate base by $17,963,000. Associated, in part, with this adjustment was a $11,009,000 reduction to construction work-in-progress for projects added to plant, unregulated plant and growth related projects.

Q. ARE THERE ANY GENERAL CONCERNS WITH CVPS'S PLANT ADDITIONS?

A. Yes. The primary concern is with plant additions that are projected. The concern is whether the projected plant additions meet the known and measurable standards. These are projects that have not started and some of them will not be completed prior to the beginning of the rate year. The costs are estimates for which little or no support has been provided. Furthermore, the Company has not reflected any associated plant retirements or cost benefits associated with the majority of the additions.

Q. WHEN ARE THE PROJECTED ADDITIONS EXPECTED TO BE IN SERVICE?

A. Some projected additions were supposed to be in service prior to this time, but they are not. In fact, several have not been started. Other projects are expected to be placed into service at various dates throughout the year 2001 and through June of 2002.

Q. WHAT IS THE PROBABILITY OF THESE PROJECTS OCCURRING?

A. That we do not know, and that is why the specific projects are not known and measurable. For many of the projects, they have not started; they do not have a work order number assigned; the costs are estimates; and there is no assurance that the estimates are reasonably accurate. In addition, we do not know if any cost savings will result from these projects. It would be inappropriate to reflect the additions without also reflecting any associated savings.

Q. MAYBE THE SPECIFIC PROJECTS ARE NOT KNOWN, BUT IS IT NOT POSSIBLE THAT SOME OTHER PROJECTS WILL OCCUR?

A. Yes, other projects probably will occur. However, one must also consider whether those projects will be at the cost level included in the filing; whether they be growth related; whether a cost savings will occur that is not reflected in this filing; and whether they will replace plant that is still included in rate base.

The bottom line is, we do not know what will occur, when it will occur, and how much it will cost. The Company has not provided a reasonable level of support to demonstrate that the projects and the associated cost estimates are known and measurable.

Q. ARE THERE ANY OTHER CONCERNS REGARDING THE PROBABILITY OF THE PROJECTED ADDITIONS BEING PLACED IN SERVICE AND SERVING CUSTOMERS DURING THE DOCKET 6460 RATE YEAR?

A. Yes. While reviewing the work orders, a number of interesting items were noted. Several of the work orders include actual in service dates that were significantly later than either the original projected completion date or even the actual completion date. One example is Work Order 9939, which was part of a reconductoring project that the Company, in a letter to the Department dated August 8, 1997, stated "These efficiency projects will be completed in 1997 and 1998." This part of the project was approved in April 1998 and was to be completed in October 1998. The work order completion notice indicates work was completed August 1999, and the project was closed into plant in September 2000. The actual project cost was overestimated by more than 10%. Another example is Work Order 9961. This work order was approved in June 1998 and projected to be completed December 1998. The work was completed in November 1999, it was booked to completed but not classified plant in January 2000, and finally booked to plant in December of 2000. This project was completed at more than 15% under the projected cost.

Similar delays were found throughout the review of the various work orders requested. The concern is if projects are completed well after the original completion date noted on the work order, then there is less assurance that projected additions which do not even have a work order number assigned will be completed as the Company has projected.

Q. WHAT OTHER CONCERNS WERE IDENTIFIED?

A. A review of the construction budget amounts to actual amounts for 1998, 1999 and the 2000 preliminary indicates the Company has not historically expended what it has estimated. In addition, it was noted in the work order review that the Company is controlling the level of capital spending such that it is not to exceed depreciation expense. The $17,917,000 average amount budgeted for 2001 and 2002 exceeds depreciation expense of $17,212,000. The various concerns evaluated both individually and combined suggest there is not a high probability of the projects occurring and/or being completed as indicated by the Company.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO PLANT IN SERVICE IN DOCKET 6460?

A. CVPS's projected plant in service should be reduced by $4,499,000. Schedule 13 identifies the respective adjustment to each category of plant. We will discuss each of the categories of plant additions separately below.

<u>Production Plant</u>

Q. PLEASE IDENTIFY THE ADJUSTMENTS MADE TO PRODUCTION PLANT IN DOCKET 6460, AND EXPLAIN WHY THE ADJUSTMENTS ARE NECESSARY.

A. The combination of our recommended reductions to production plant results in a $479,000 reduction to the rate year thirteen-month average production plant in service balance. The first adjustment increases the interim year WO 6219 thirteen-month average for the rate year from $173,811 to $321,379. The Rutland GT 5 Fuel Control Upgrade incurred problems during the initial startup, causing the project costs to increase. The increase was actually expended and needs to be reflected in the filing.

Next, we removed four interim year projects from the Company's project list. These projects have not yet been assigned a work order, and no support was provided for the "initial engineering estimate." The projects are as follows:

Clark Fall Breaker/PTs/Relays	$50,000	
Fairfax Transformer		25,000
Pierce Mills Switches		5,000
Gage Structure Repair	15,000	

The $50,000 Clark Falls project, which has not started, was projected in the Company's filing to have been completed by December 2000.

Q. WHICH OF THE COMPANY'S PROJECTED DOCKET 6460 RATE YEAR PRODUCTION PLANT ADDITIONS ARE YOU ADJUSTING?

A. The Company has included a thirteen-month average of $586,152 in its production plant additions for 13 projects. Of the 13 projects, only the Silver Lake Penstock project has been assigned a work order. The total cost is now estimated to be $29,944 less ($23,034 on thirteen-month average basis), and nothing has been expended on the project to date. No support was provided for the "initial engineering budget estimates" on the remaining twelve projects. An adjustment of $532,263 is required, removing $509,229 of estimated costs for the twelve projects that are not known and measurable and reflecting the $23,034 reduction in the Silver Lake Penstock project.

Q. DOES THAT CONCLUDE YOUR CONCERNS AND ADJUSTMENTS FOR PRODUCTION PLANT IN DOCKET 6460?

A. No. We have concerns regarding the interim year Pittsford Penstock Project (WO 6191), the Clark Falls Governor Project (WO 6263), the Peterson Governor Project (WO 6265) and the Ascutney GT 4 Breaker Project (WO 6217). All four projects were projected by CVPS to be closed as of December 2000. The two governor projects, each at $50,000, have no expenditures to date, and the work orders were just issued. According to the response to DPS 4-32, the Pittsford Penstock Project and Ascutney GT 4 Breaker Project are still on going;

however, they are $172,102 and $40,011, respectively, under the cost estimates included in the filing. Although we have not yet adjusted for the unexpended $212,113, we do recommend that the Company provide updated information on these projects to provide assurance the costs will be expended and the projects are near completion.

Transmission Plant

Q. PLEASE EXPLAIN YOUR ADJUSTMENTS TO TRANSMISSION PLANT IN DOCKET 6460.

A. Overall, our adjustments to transmission plants results in a reduction to the rate year thirteen-month average plant in service of $887,000. No adjustments are being made to the test year amounts for substations or transmission lines. We do note that the Company did not reflect a $12,000 credit for salvage to Work Order 6117 in the test year.

In the interim year, we have increased the substation blanket WO 32 from the thirteen-month average amount of $100,893 to $121,165. This adjustment reflects the actual cost recorded when the work order was closed. As was done with production, we have removed three interim year substation projects that have not been assigned work orders. We have been provided no support for the estimated costs. In fact, two of the projects were projected in the filing to have been completed in the year 2000. This did not occur. The projects are as follows:

GPS Time Sync for Relays & Fault Recorders	$25,000
Battery Replacement	30,000
Taftsville Substation - Replace Airbreak	25,000

As for the interim year transmission line projects, we are adjusting two projects. The Stockbridge installation of 2 MOABs (WO 6172) is increased from the thirteen-month average of $30,975 to $44,413. This reflects the actual costs to date. The project was scheduled to be completed in November 2000, but it is now scheduled to be completed in February 2001. The other project is the blanket WO 32. According to the Company's response to DPS 7-4(b), the project is closed and the cost should be reduced $253,550 from the thirteen-month average estimated amount of $327,876 to $74,326.

Q. WERE THE REMAINING INTERIM TRANSMISSION PROJECTS COMPLETED AS INDICATED BY THE COMPANY?

A. No. Substation Work Orders 6173 and 6175 have minor actual cost differences, and the Vernon Road Switchgear Upgrade (WO 6223), which has a thirteen-month average of $563,861 included in the filing, only has $178,222 of costs to date. This project is scheduled for completion in June 2001, so no adjustment has been recommended. We would like to point out that the work order indicated $389,000 was to be expended in 2000. Consequently, the project is either under budget or behind schedule. This project should be watched carefully. The interim year transmission line projects not adjusted include nine work orders where actual costs are different and the closing date on some has been delayed. At this time, the thirteen-month average of $220,546 included in the filing for these nine work orders is $32,076 over the actual costs to date. This excess in the filing includes the installation of a loadbreak switch at Jeffersonville (WO 6201) for $15,865, which was scheduled to be completed in December 2000, but has yet to begin.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO TRANSMISSION PLANT FOR THE DOCKET 6460 RATE YEAR.

A. For the substations, we removed $645,768 for the nine projects that are not known and measurable. As stated previously, the projects are not being completed as scheduled, and no support has been provided to quantify the costs requested. An example of the lack of support can be seen in the response to DPS 9-3, which has been included in Exhibit DPS-L&A-4, at pages 51 through 53. The support provided in this responses consists of numbers only. Due to its recurring nature, Blanket Work Order 32 has not been adjusted.

The rate year transmission line projects the Company has requested total to a thirteen-month average of $231,838. We have not adjusted the reconstructor projects on North Elm Street (WO 9945) and Vernon Road (WO 9937). The North Elm Street has not begun, and the Vernon Road actual cost to date are on target. Due to carry-overs from 2000 on the Blanket Work Order 32, we increased the Company’s amount from $47,760 to $249,013. The remaining six projects, which total $142,308, are not known and measurable and have been removed in our adjustment.

Distribution Plant

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO THE DOCKET 6460 DISTRIBUTION PLANT ADDITIONS?

A. The distribution adjustment is a reduction to thirteen-month average plant in service of $2,319,486. The adjustments are $488,462 to substations, $151,923 to distribution purchases and $1,679,101 to distribution reconstruction.

Q. WHAT ADJUSTMENTS ARE BEING MADE TO DISTRIBUTION SUBSTATIONS?

A. Docket 6460 rate year projected additions included three proposed projects with total estimated costs of $800,000. The test year and interim year project costs, excluding the Blanket Work Order 34, are approximately $300,000 each year. The proposed costs are not comparable to the other two years, no work order exists, no retirements have been reflected in the filing, and the probability of occurrence or time of completion is not known. In fact, the Wallingford project estimated completion date has been set back from September of 2001 to December 2001. The thirteen-month average amount requested by CVPS should be reduced by $488,462.

The interim period additions that were incorporated in the filing total $378,352; the total actual costs to date are $338,098. Even though the original project completion was December 2000, the Company has indicated that completion was delayed to 2001. Based on the assumption that completion will take place in the very near future and additional costs could be incurred, we did not adjust these amounts.

Q. WHY ARE YOU ADJUSTING THE DISTRIBUTION PURCHASES?

A. The Company included in each of the three years (i.e., test year, interim year and rate year) costs for transformers (WO 36), regulators and capacitors (WO 37), and meters (WO 38). The interim and rate year additions are based on budgeted amounts. To determine the reasonableness of the estimates, we calculated a four-year average amount for each of these work orders (1996-1999) on Schedule 14. The amounts on Schedule 14 are net of retirements for each of the respective work orders. The transformers average of $918,792 multiplied by the transformer non-growth rate of 50.22% equals $461,417. The Company additions in the interim year and the rate year were $454,559. The additions appear reasonable.

The regulator and capacitor four-year average additions were $137,854. The Company included $253,316 in the rate year. That amount is more than twice the test year additions of $112,480 and almost twice the four-year average level. Using the four-year average cost as a guide, we reduced the rate year additions by $100,000. The reduction to $153,316 ($253,316 - $100,000) is close to the four-year average of $137,854. It is also close to the Company's $152,234 two-year average for the test year and interim period additions.

The four-year average additions for meters were $81,519. The Company included $175,822 in the interim period and $252,562 in the rate year. The estimates for the two periods are considered excessive when compared to the average and taking into consideration the fact that test year additions were abnormally high. The interim year was reduced $75,000 to $100,822, and the rate year was reduced $150,000 to $102,562, a level somewhat more comparable to the $81,519 four-year average. The thirteen-month average adjustment to the rate year for the $325,000 of interim and rate year reductions to plant is $151,923.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT FOR DISTRIBUTION RECONSTRUCTION PROJECTS IN DOCKET 6460.

A. The distribution reconstruction additions consist of three categories: reconstruction, road relocations and telephone reconstruction. The Company's interim and rate year amounts were based on budgeted amounts. We utilized a four-year average of actual expenditures, as shown on Schedule 14, to determine whether the estimates were reasonable. The road relocations and telephone reconstruction were determined to be reasonable. The annual average for reconstruction was $2,276,671, and the Company included $3,396,910 in the interim year and $3,394,380 in the rate year. The estimates are considered excessive. We reduced the interim year and rate year plant addition amounts by $1,120,249 and $1,117,709, respectively, to reflect the four-year average cost level. The affect of this adjustment, based on a thirteen-month average rate year is a reduction to distribution plant of $1,679,101.

Facility Plant

Q. WHAT ADJUSTMENTS ARE YOU PROPOSING TO THE COMPANY ADDITIONS TO FACILITIES IN DOCKET 6460?

A. A reduction of $235,00 should be made to the Company's requested $941,000 of additions in the filing. The first adjustment is an increase of $9,039 to the test year addition for the installation of a fuel tank at the engineering building (WO 9867). In responding to DPS 4-44, the Company was alerted to an error in its filing. The actual cost incurred was $9,821 more than that included in the filing. After applying the CVPS allocation factor, the adjustment of $9,039 is required to correct the error.

Q. WHAT ABOUT THE INTERIM YEAR?

A. In the interim period, two projects were canceled, the cost of two projects were increased due to additional actual costs being incurred, seven projects are not known and measurable, and there is a concern regarding the rebuild of the control center project (WO 6244). The work order and actual costs were not provided for Work Order 6244, and thirteen additions totaling $84,760 do not have work order numbers assigned. Of the thirteen, only two have a quote or estimate provided by an outside vendor. The adjustments we are recommending to the thirteen-month average for the interim year additions are as follows:

Emergency Generator (WO 6238) - Actual Costs		$51,272
Restroom Renovations - Canceled		(19,329)
Transformer Dock, Crane - Actual Costs		17,798
Slope Stabilization - Canceled	(30,000)	
Ceiling & Carpet Replacement General Office - Not K&M		(10,124)
Engineering Carpet Replacement - Not K&M	(4,602)	
Turbine Walk Icing Problem - Not K&M		(4,602)
Brattleboro Window, Door & Frame - Not K&M		(3,000)
Middlebury Unit Heater - Not K&M		(2,100)
District Copiers & Maintenance - Not K&M	(13,500)	
5 Desk Chairs		(2,500)
		(20,687)

Q. WHY DID YOU ALLOW SOME OF THE PROJECTS THAT WERE NOT YET STARTED?

A. As indicated earlier, the Company provided quotes for two projects, the system operations card key readers and the replacement of the trailer roofing at Bradford. The other projects we left in were based on the need established in Company testimony and on the presumption that the projects could be specifically required by the Board, based on need, to be completed by the time rates go into effect. The projects are as follows:

Engineering Building Emergency Generator
Disaster Recovery Room and Record Center HVAC
System Buildings Underground Tank

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING TO FACILITIES IN THE DOCKET 6460 RATE YEAR?

A. The Company has requested a thirteen-month average of $262,279 be included as rate year additions. The projects are predominately in-house estimates, no work order numbers have been assigned, and there is no evidence in the filing that there is a high probability of occurrence. However, based on three quotes provided in responses to Department inquiries, we left $39,474 of the requested rate year additions in plant in service. The following were not adjusted out of requested plant in service:

Systems Operations Storage Space
Risograph Machine
Offset Printer and Postage Equipment

The other $222,805 requested by the Company is not known and measurable. They are additions desired with in-house estimates for cost and no assurance the projects will begin and/or be completed prior to the end of the rate year.

Information Systems Plant

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR THE INFORMATION SYSTEMS ADDITIONS IN DOCKET 6460?

A. An adjustment of $49,946 was made, reducing the Company's requested amount from $3,913,226 to $3,862,280. No changes were made to test year additions. The interim period was increased $130,297 based on more up-to-date actuals, and the rate year thirteen-month average was reduced $180,243 for the projects that do not meet the known and measurable tests.

The updated actual amounts for the interim period were provided in the Company's response to DPS 3-37. In response to DPS 6-47, some support was provided for two projects not yet started; however, the response also identified retirements for Work Orders 6061 and 6158 that have not been accounted for in the filing. Sufficient information was not provided to reflect the impact of these retirements. The Company should be required to provide the full impact of these retirements on the filing.

The Company did not provide sufficient information to support the known and measurable standard for five of the six rate year additions. The only rate year support provided was estimated contract programming time for the WMS Transmission project. This information, while detailed, fails to sufficiently quantify the dollars associated with the project. The Board may consider an additional adjustment of $101,737 if it is determined the information supplied does not meet the known and measurable standard.

Communication Plant

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO THE COMMUNICATION PLANT ADDITIONS IN DOCKET 6460.

A. The Company's requested rate year thirteen-month average communication plant should be reduced by $529,000. No changes were made to test year additions, even though the net difference of actual cost to the amounts included in the filing was $4,615. In the interim period, we made three adjustments. The Claremont Microwave Project (WO 6222), which was to be completed in December 2000, is still in progress, and actual costs to date are $9,101 higher than projected. The second adjustment increases the CVPS backbone network upgrade (WO 6180) by $13,446 to the actual closing cost of $230,137. Based on the response to DPS 4-33, the Fiber Loop Completion Project (WO 6246) and the Test/Development of the IVR System were not started yet, even though completion was scheduled for December 2000. The projects are not known and measurable, and an adjustment of $204,804 is required. It is interesting that a follow-up response to DPS 4-33 states that the test/development IVR system is now completed. This was accomplished in 21 days.

Q. ARE ANY OF THE DOCKET 6460 RATE YEAR ADDITIONS KNOWN AND MEASURABLE?

A. Not entirely. The only addition which actually approaches the known and measurable test is the PBX-Upgrade. In response to DPS 4-40, the Company provided copies of proposed capital leases for a PBX system. The cost is not determined yet because of the alternatives, so it could be that this project is not quantified. In response to DPS 7-7, the Company stated the cost information is used purely for budgetary purposes, and an RFP will be sent out once the needed analysis is completed. We removed the $346,499 thirteen-month average balance associated with the PBX system and the twelve other rate year project additions that are not known and measurable. No detail exists supporting the occurrence or the reasonableness of the amounts requested for the rate year additions.

Working Capital

Q. DID YOU REVIEW THE COMPANY'S WORKING CAPITAL REQUEST IN DOCKET 6460?

A. Larkin & Associates was retained by the Department to review and address CVPS's rate case filing in Docket No. 5863. As part of that case, we reviewed CVPS's lead/lag study. In that case, the Company determined its working capital requirement based on a lead/lag study performed in 1989, modified using data from October 1992 to September 1993. The Company is using the same study in this proceeding.

Q. WHY WOULD THE COMPANY CONTINUE TO USE THIS OLD, OUTDATED STUDY?

A. The Company claims that it assessed the study and determined the changes that have occurred would increase the working capital requirement. To minimize costs, it elected to re-use the old study instead of performing a new study. The Company was asked if it did an analysis to support its continued use of the study. In response to DPS 7-19, the Company stated that "Power vendors have not appreciably changed their payment terms since the 1992/1993 study," and "(t)he Company's on-going review of the aging of accounts receivable indicates the customer payment lags have increased since 1992-3." Clearly, no detailed analysis was performed.

Q. WHAT FACTORS HAVE CHANGED THAT WOULD AFFECT THE LEAD/LAG

STUDY?

A. The collection lag appears to have shortened. Based on the limited response to DPS 7-20, the collection lag for the test year and the year 2000 is 23.73 and 25.83 days, respectively. The Company's working capital calculation uses a total revenue lag of 48.43 days. Based on a 365 day year and 12 months of billing, there is a service period of 30.42 days and a service lag of 15.21 days. In response to DPS 7-23, the Company indicates a typical billing lag of 3 days. Based on a service lag of 15.21 days and a billing lag of 3 days, the collection lag effectively used by the Company would be 30.22 (48.43 - 15.21 - 3). Based on my calculation of a 25.81 day collection lag for the year 2000, the Company's revenue lag is overstated by 4.39 days (30.22 - 25.83).

Q. ARE THERE OTHER CONCERNS WITH THE COMPANY'S REVENUE LAG CALCULATION?

A. Yes. The Company assumes a 3 day billing lag. The original study assumed 5 days. With the technological changes that have occurred over the years, the 3 day billing lag is likely excessive. According to the Company's response to DPS 7-23, the 3 day lag is the result of management's decision to allow a 5 day window to provide flexibility for the multi-tasking meter readers to perform their other duties of service orders and collections. Meter reading results should be uploaded daily.

Another concern is with the collection lag. Based on the response to DPS 7-1, the account receivable balance is higher than it should be. First, the Company has a problem reconciling the accounts receivable balance on its books. Second, the collection efforts on delinquent accounts has not been performed as Company policy dictates. If the accounts receivable is overstated due to record keeping errors and/or failure to follow-up on past due accounts, the collection lag would be overstated as a result.

Q. DID YOU TEST ANY OF THE EXPENSE LEADS?

A. Yes. We tested the purchase power lead days and made inquiries into the payroll lead. The purchased power lead did test-out to exactly the same 35.77 day lead in Docket No. 5863. The payroll lead, ignoring any check clearing days, would remain at 8.5 days.

Q. ARE THERE OTHER INDICATIONS OF CHANGES?

A. Yes. In Docket No. 5863, we noted that the expense lead had lengthened and that the expense lead did not consider a check clearing lag. In our testing of the purchased power lead, we calculated an average check clearing lag of 4.58 days. This is not an immaterial amount of time. The Company, on the other hand, stated in response to DPS 7-19 that its "...payment lags are <u>thought</u> to have shortened." (Emphasis added.) This Company position (or thought) is not supported by any study or facts. On Schedule 15, page 5, we assumed the same lead times in the original study and determined that even with a shift in dollars, the lead time remains relatively the same. However, by removing non-cash items such as bad debts and amortization, the lead would increase by 1.75 days. This adjustment was not made. As shown on Schedule

15, page 5, we added only 3 days to the expense lead for check clearing.

Q. WHAT ADJUSTMENT TO WORKING CAPITAL DID YOU MAKE IN DOCKET 6460?

A. Even though we calculated a change in the revenue lag days of 4.39 days, we assumed a very conservative change to the revenue lag days of 3 days. This conservative change, plus the check clearing lag adjustment to Other O&M and the impact from other operating and rate base adjustments made by the Department, reduces the Company's requested working capital requirement by $3.039 million. This adjustment, along with the supporting calculations, is provided on Schedule 15.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does. However, we would like to reiterate that the revenue requirement amounts presented in this testimony and in Exhibit DPS-L&A-3 do not yet include the impact of any prudence related issues, such as the Vermont Yankee power uprate adjustment and Hydro Quebec issues.